Witness CCS - 1

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In The Matter Of The Application	**:**	**Docket No. 03-035-14**
Of PacifiCorp For an Order	**:**	**Direct Testimony Of**
Approving Avoided Cost Rates	**:**	**Kelly Francone for the**
	:	**Committee of**
	:	**ConsumerServices**

12 April 2004

Introduction

Q. Please state your name, business address and current position.

A. My name is Kelly Francone. My business address is 160 East 300 South, Salt Lake City, Utah. I am a utility analyst for the Committee of Consumer Services (Committee).

Q. Have you previously presented testimony before this Commission?

A. Yes. I have testified regarding the Home Electric Lifeline Plan (HELP) for low-income customers (Docket No. 99-035-10), PacifiCorp's (Company) Hunter Unit 1 outage (Docket No. 01-035-23), Magnesium Corporation's avoided costs (Docket No. 02-035-02) and have filed testimony before the Public Service Commission (Commission) on the Life Support addition to the HELP program and Questar Gas Company's weatherization and customer charge issues.

Q. What is the purpose of your testimony?

A. The primary purpose of my testimony is to present the Committee's position regarding specific issues in PacifiCorp's petition for an order approving avoided cost rates for over 1 MW. These include the renewable energy credit (Green Tag) entitlement of Qualifying Facilities (QFs) introduced by PacifiCorp Witness Mark Tallman. I also address issues relating to new accounting rules implemented by the Financial Accounting Standards Board (FASB), that are introduced in the direct testimonies of PacifiCorp witnesses David Mendez and Bruce Williams. Finally, I introduce the testimony of Mr. Phil Hayet, a consultant retained by the Committee to examine the avoided cost methodology proposed by PacifiCorp for Schedule 38.

Q. Please explain the Green Tag Issue.

A. As stated by Mr. Tallman on page 6 of his direct testimony, Green Tags, also known as renewable energy credits, are a marketable environmental aspect of the renewable energy industry. Green Tags were developed to aid in the development of renewable energy resources and exemplify a valuable currency that can be traded or purchased. Green Tags can be sold to utilities in states that have a Renewable Portfolio Standard (RPS), under which utilities are required to either produce power with a mix of generation resources that include renewable energy, or to purchase Green Tags as a substitute for such resources.

Q. Who determines the appropriate ownership of the Green Tags?

A. Because Green Tags exist outside the confines of the Public Utility Regulatory Policies Act (PURPA), their entitlement is not defined under PURPA rules. This emerging issue is currently being addressed by State Commissions, particularly those with RPS.

There are three general points of view about ownership. QFs argue that they should retain the Green Tags because environmental risks for the generator and environmental benefits to the public are not accounted for in the avoided cost paid for electricity. Some utilities contend that PURPA's intent was for utilities to purchase all of the components of the QF power, including any environmental attributes. Others suggest that because utility customers are paying the cost of the PURPA contracts, they should receive the benefits of the Green Tags.

Q. Does PacifiCorp have a specific recommendation?

A. Yes. On page 6 of his testimony, Mark Tallman recommends that PacifiCorp customers should receive the benefits of the Green Tags.

Q. Has there been a ruling made at the national level on the ownership of Green Tags?

A. Yes. On 1 October 2003 the Federal Energy Regulatory Commission (FERC) granted a petition for declaratory order (CCS Exhibit 1.1) affirming that "absent express provision in a contract to the contrary," Commission rule or State law, the Green Tag ownership remains with the QF. The FERC noted that the issue is outside of PURPA and because renewable energy credits were created by states, their designation is a state issue.

Thus, state commissions and state legislatures have the authority to determine Green Tag ownership.

Q. Has the ownership issue been addressed by other states?

A. Yes. Nevada has regulations in place that require the Green Tags to remain with the QF. Idaho Power has recently filed a petition with the Idaho Public Utilities Commission that also recommends QF retention. The issue is also being examined in Maine, where the electricity market has been restructured. The Maine Public Service Commission staff recently recommended that the Green Tags transfer to the utility purchasing QF power based on the consideration QF prices paid by ratepayers sometimes unintentionally result in above-market prices. In other words, the transfer of the renewable benefits would help to offset any potential "stranded costs" paid by ratepayers.

Q. What is the Committee's conclusion concerning the Green Tag issue?

A. While the Green Tag matter is an emerging issue, the Committee believes that it is ultimately ratepayers who underwrite the avoided costs paid to QFs. Thus, we recommend that the customers should receive the associated benefits off the Green Tags.

Q. Does the Committee have a recommendation on the value that should be ascribed to the Green Tags?

A. Without further analysis of this emerging issue, the Committee does not have a specific recommendation at this time. As can be seen from PacifiCorp's testimony, the Blue Sky program and prices paid in the market (CCS Exhibit 1.2), there is a wide divergence in the value. On page 7 of his direct testimony, Mr. Griswold recommends a value of $5 per MWh for the first five years based on what is used in the IRP. However, in PacifiCorp's response to CCS DR 2.9, which asked for an adjustment for Green Tags in a hypothetical example of a wind QF, the Company demonstrates a renewable energy value of $1.69/MWh. In the Blue Sky program, customers pay $1.95 per 100KWh to support renewable energy.

PacifiCorp spends the resulting $19.50/MWh in the market to buy Green Tags. In addition, CCS Exhibit 1.2 indicates that renewable energy credits are selling in the eastern power markets between $45 and $55/MWh. Because a wide range of prices are currently being paid for Green Tags, the Committee believes the value determination requires further study.

Q. Please identify the new accounting rules implemented by FASB that may impact avoided costs.

A. As noted by PacifiCorp witness David Mendez, two accounting standards have recently been implemented, Emerging Issues Task Force (EITF) 01-08 and Financial Interpretation No. 46R (FIN 46R).

Q. What is the purpose of these accounting standards?

A. Implemented 1 July 2003, EITF 01-08 affects how companies must review power purchase contracts under lease accounting rules. For several decades, FASB has required full disclosure of leasing transactions. This recent decision affects what types of contracts, such as certain types of Power Purchase Agreements (PPA), may be viewed as leases, and therefore require disclosure on the Company's balance sheet. According to FASB standards, a QF contract qualifies for capital lease treatment if it depends on a specific plant and the purchaser takes a majority of the output.

The modification to FIN 46R became effective 31 March 2004. It provides guidance for identifying the party with a controlling financial interest resulting from contract arrangements. This clarification would apply if the Company is considered the primary beneficiary of an entity. FIN 46 defines the term "variable interest entity" (VIE) and is based on the premise that if a business has a controlling financial interest in a VIE, then the assets, liabilities, and other results from business activities should be included in the financial statements of, in this case, PacifiCorp.

Q. Does PacifiCorp believe these standards will affect its QF contacts and the resulting avoided costs?

A. Yes. Starting on line 1, Mr. Williams notes on page 2 of his testimony, that these standards will have impacts on both the Company's financial commitments and credit quality. He also states that the recognition of the additional debt will impose additional costs on both PacifiCorp and its customers.

Q. What does PacifiCorp recommend to remedy the impact?

A. On page 4 of his testimony, PacifiCorp witness Bruce Griswold recommends that the debt-related cost be addressed as a defined term in the PPA that would be applied as a monthly line-item adjustment to the QF monthly payment. Mr. Williams also recommends on page 5 of his testimony that PacifiCorp apply a 30% risk factor as the debt equivalent for the QF obligation.

Q. What impact would those actions have on the QF avoided cost?

A. In its response to DPU's DR 1.47, PacifiCorp states that a line item adjustment will be made to the total amount the QF will be paid. If the Commission adopts PacifiCorp's recommendations, the avoided cost capacity payment to the QF would decrease.

Q. What conclusion did the Committee reach on the impact of these financial standards?

A. Based on the analysis of consultant Donna DeRonne, a Certified Public Accountant who actively participated in PacifiCorp's last four Utah rate cases, the Committee does not believe PacifiCorp has demonstrated that the FASB modifications will necessarily have a material impact on its costs for QFs. Ms. DeRonne has indicated that FIN 46R may be inapplicable if PacifiCorp is not at risk for losses or does not take any residual profits from the QF. As noted previously, it may only have an impact if the Company is considered the primary beneficiary of an entity, or in this case, has a controlling interest in the QF.

Ms. DeRonne also notes that because FASB has required full disclosure on the material impacts of PPAs for several decades, it is not clear how the increased transparency would affect perceptions of investors or credit ratings. Rating agencies like Standard & Poor's have already been considering the impact on cash flows and will continue to do so. It is also possible that the investment community may take a favorable view of the increased transparency, which could have a positive effect on the Company's financial standing.

Q. Has this issue been addressed in any other PacifiCorp jurisdictions?

A. Yes. The staff of the Oregon Public Utility Commission provided recommendations (CCS Exhibit 1.3) on 23 January 2004 to its Commission. The Oregon staff findings reflect those of Ms. DeRonne's in that they did not believe PacifiCorp had demonstrated that the FASB changes will necessarily have a material impact on the Company. The staff also noted that the investment community has required full disclosure for decades, and thus, will most likely not impact PacifiCorp's financial health.

Q. What actions did the Oregon Commission take?

A. In its 18 February 2004 Order (CCS Exhibit 1.4), the Oregon Commission agreed that it was not persuaded that the new FASB standards would have a negative impact on PacifiCorp. The Commission adopted the staff recommendation that PacifiCorp may consider the effect of the FASB standards only after the Company performs a cost-effectiveness analysis for each PPA. The Commission noted that if the subsequent economic analysis properly identified increased cost or risk to PacifiCorp, then the Company could provide such an analysis for subsequent staff review and ultimately a Commission decision.

Q. What does the Committee recommend?

A. The Committee believes that PacifiCorp should have to demonstrate that any contract may have a negative impact on its financial standing by assessing each QF's potential burden to the Company. We therefore recommend that the Utah Commission follow in the steps of the Oregon Commission. Specifically, the Commission should direct PacifiCorp to assess the financial risk on a case-by-case basis and present a detailed analysis to the Commission to determine whether the avoided costs paid to the QF should be reduced.

Q. Does this conclude your testimony?

A. Yes.